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MANAGEMENT BULLETIN 02-05

July 17, 2002

To: County and District Superintendents
Charter School Administrators

Attention: County and District Chief Business Officers

From: Susan Lange, Deputy Superintendent
Finance, Technology and Administration Branch

Subject: **REDUCTIONS IN 2001-02 APPROPRIATIONS—ROUND TWO**

Governor Gray Davis signed AB 3008 (Chapter 99, Statutes of 2002) on June 30, 2002, and AB 3011 (Chapter 101, Statutes of 2002) on July 1, 2002. These bills implement reductions, funding shifts, and deferrals affecting various 2001-02 appropriations for Proposition 98 purposes. Action on the Budget Bill for 2002-03 is still pending. This bulletin provides an update on budget actions to date. Copies of this bulletin, as well as future budget-related documents, will be available at <http://www.cde.ca.gov/fiscal/> on the California Department of Education's web site. Copies of budget documents themselves are available through the Department of Finance's web site (<http://www.dof.ca.gov/>).

PRELIMINARY ACTION ON 2002-03 BUDGET

The state revenue picture for 2002-03 has worsened since January. In the May revision of the budget, the Department of Finance (DOF) cited "a precipitous decline in revenues from the personal income tax on capital gains and stock options" and a national recession. In January, the DOF projected a \$12.5 billion gap between projected revenues and projected expenditures over the two-year period ending in 2002-03. In May, the DOF projected a \$23.6 billion gap.

To bridge this gap, the May revision proposed a mix of program reductions (\$7.6 billion), tax increases, and "the maximum fiscally responsible level of fund shifts, loans, accelerations, transfers, and deferrals." As indicated above, the Legislature passed a portion of the budget package involving reductions, funding shifts, and deferrals affecting various 2001-02 appropriations for Proposition 98 purposes. These actions have the effect of freeing up non-Proposition 98 funds because Proposition 98 funding in 2001-02 was (and still is) significantly higher than the guarantee amount.

The Legislature has not taken final action on the budget for 2002-03. Although the Senate reached agreement on a 2002-03 budget package, it appears unlikely that the Assembly will approve the version of the budget passed by the Senate.

PROPOSITION 98 CHANGES

The May revision of the Governor's proposed budget reflected a reduction of \$2.1 billion in 2001-02 Proposition 98 appropriations for K-12 schools compared to the 2001 Budget Act. This figure consisted of \$454 million in reductions that were approved by the Legislature in February and \$1.6 billion in reductions, funding shifts, and deferrals that were newly proposed in May. In AB 3008 and AB 3011, the Legislature approved \$1.7 billion in reductions, funding shifts, and deferrals.

The May revision of the budget also reflected a net increase of \$106 million in funding for K-12 purposes from one-time funds in 2001-02. These one-time funds are reverted from previous Proposition 98 appropriations so they must be spent for Proposition 98 purposes, but they do not count in the Proposition 98 totals. The \$106 million figure consisted of \$397 million in reductions that were approved by the Legislature in February, offset by a \$503 million increase proposed in May to replace ongoing funding for adult education. (The net increase in one-time funds was possible as a result of May budget proposals to reduce spending from one-time funds in 2002-03.) In AB 3008, the Legislature approved the Governor's 2001-02 funding proposal for adult education.

Specifically, AB 3008 and AB 3011 contain:

- \$1 billion in deferrals. AB 3008 eliminates 2001-02 appropriations for five programs. AB 3011 replaces all or a portion of the appropriations with 2002-03 funds.
- \$503 million in funding shifts. AB 3008 reverts \$503 million in adult education funding, replacing this amount with one-time funds.
- \$144 million in 2001-02 program reductions.

The changes are discussed in greater detail below and listed in Table 1 on page 5.

Deferral of Funding from 2001-02 to 2002-03

AB 3008 eliminates 2001-02 appropriations for five programs. AB 3011 replaces all of the 2001-02 funding with 2002-03 appropriations for three of the programs:

- Targeted instructional improvement grants, \$713 million.
- Instructional time and staff development reform, \$76 million.
- Testing, STAR, \$60.6 million. Of these funds, \$12 million is for apportionment to local educational agencies.

AB 3011 replaces a portion of program funding with 2002-03 appropriations for two programs:

- High achieving/improving schools—reduced from \$144 million to \$67 million. The remaining \$77 million may be restored in the 2002 Budget Act.
- Beginning teacher support and assessment—reduced from \$39 million to \$14 million. The \$25 million reduction represents funding that would otherwise revert.

The funds for all five of these programs are normally distributed to local educational agencies either late in the fiscal year or in the following fiscal year.

Funding Shifts

AB 3008 deletes \$503 million from the 2001-02 appropriation for adult education and appropriates \$503 million in one-time funding to replace the ongoing funds.

Funding Reductions

AB 3008 implements a number of funding reductions in 2001-02, most of which are technical and reflect lower expenditures than originally budgeted. The most significant is a \$20 million reduction to the high priority schools grant program. This reduction is in addition to a reduction of \$159 million implemented in February. The effect will be to delay funding for planning grants to schools in decile 2 of the Academic Performance Index. The \$20 million reduction may be restored in the 2002 Budget Act.

ISSUES FOR LOCAL EDUCATIONAL AGENCIES

The status of current budget negotiations raises two important issues for local educational agencies: (1) how to account for funding deferrals such as the ones that have already been enacted and (2) which particular funding streams will be held up if the budget is not passed for an extended period.

Accounting for Funding Deferrals

The state's action to shift funding for certain programs to 2002-03 raises financial reporting issues for LEAs. The reason that the state's action causes a problem is that some LEAs incurred program expenditures in 2001-02 based on anticipated funding that was originally appropriated in the 2001 Budget Act for use in 2001-02 — then the funds were shifted to 2002-03.

The Governmental Accounting Standards Board (GASB), in accordance with Statement 33, indicates that districts should not accrue revenues not yet appropriated by the granting agency. However, some LEAs have taken the position that these are unique circumstances, that they acted in good faith in conducting program activities based on appropriations that existed at the time, and that the state recognized its obligation as of June 30, 2002 to fund these programs, as shown by its action in providing new appropriations on July 1. The belief is that these circumstances, combined with the LEAs' reasonable expectation of receiving the program funds by August 1, 2002, justify the accrual of revenues for the programs as of June 30. Some auditors also support this position.

We recognize that the state's shifting of appropriations from one fiscal year to the next, during the last moments of that fiscal year, raises unusual accounting issues for which there is little precedent. If you believe that the accrual of a receivable is appropriate, we recommend that you discuss the potential accrual with your auditor before accounting for the funds in this manner.

Impact of Continued Budget Delays

The Second District Court of Appeal of the State of California recently issued its opinion in the case of *White v Davis*. This case was filed by the Howard Jarvis Taxpayers Association to prevent the State of California from issuing funds in the absence of an approved state budget. The court's decision held that there are four categories of funds that may be disbursed by the state in a fiscal year in the absence of a budget act or emergency appropriation.

1. All apportionments made from continuing appropriations found in statutes and other provisions of law.
2. Salaries of elected state officers and allocations to the State School Fund that are related to a triggering of the Gann limit.
3. Payments (e.g., minimum wages, overtime compensation) required under the Fair Labor Standards Act.
4. Federal mandates associated with the Food Stamp program, Foster Care and Adoption programs, Child Support programs, and Child Welfare Services programs.

The court's decision affects all funding distributed by the state, including funds apportioned pursuant to Article XVI, Section 8 (Proposition 98) of the California Constitution. Therefore the state is not authorized to apportion funds to meet the Proposition 98 guarantee unless the funds fall into one of the four categories listed above. The court did, however, state that the writ of *supercedeas* will remain in effect until the issuance of the court's *remittitur*.

A Petition for Review has been filed with the California Supreme Court by the Attorney General's Office requesting that the stay of this decision remain in effect until after the California Supreme Court has reviewed this matter. Whatever the ultimate ruling, we will distribute revenue limit funding because the apportionment is based on statutory provisions rather than the budget act. We will also distribute other funds where the apportionment is based on a statutory appropriation, such as the appropriations in AB 3011. The CDE is coordinating with the Attorney General's Office and the State Controller's Office to further examine the impact of this decision on other specific apportionments, in the event that the stay is not granted. More information on this issue will be made available as it develops.

Questions regarding this bulletin should be directed to the Fiscal Policy Office of the School Fiscal Services Division at (916) 323-8068.

NOTICE:

The guidance in this bulletin is not binding on local education agencies or other entities. Except for the statutes, regulations, and court decisions that are referenced herein, this bulletin is exemplary, and compliance with it is not mandatory. (See Education Code Section 33308.5.)

Table 1
2001-02 Budget Reductions and Related 2002-03 Increases
(In Thousands)

	February Reductions	June Reductions	01-02 Total	02-03 Increases
Funding shifts and deferrals				
Targeted instructional improvement grants		\$713,360	\$713,360	\$713,360
High achieving/improving schools		144,300	144,300	67,300
Instructional time and staff development reform		76,000	76,000	76,000
Testing—STAR		60,643	60,643	60,643
Beginning teacher support and assessment		39,000	39,000	14,000
PERS offset	-\$35,000		-35,000	
Categorical programs per ADA allocation	-67,831		-67,831	
Adult education		503,433	503,433	
Subtotal	-102,831	1,536,736	1,433,905	931,303
Reductions				
High priority schools grant program	159,000	20,000	179,000	
Teaching as a priority block grant	118,650		118,650	
Certificated staff performance incentive	100,000		100,000	
Peer assistance and review	50,000		50,000	
CalSAFE implementation delay		44,233	44,233	
Healthy start	38,000		38,000	
Ninth grade class size reduction	10,000	25,000	35,000	
Digital high school	15,000	11,000	26,000	
Before/after school expansion	22,200		22,200	
Child development		20,014	20,014	
Beginning teacher support and assessment	20,000		20,000	
High Achieving/Improving Schools	12,700		12,700	
Charter school facilities grants	5,000		5,000	
National Board for Professional Teaching Standards	5,000		5,000	
Testing—STAR contract		5,000	5,000	
Advanced Placement challenge grants		4,000	4,000	
High-risk youth education and public safety		4,000	4,000	
Commission on Teacher Credentialing		1,284	1,284	
High school coach training	1,000		1,000	
Miscellaneous changes		9,734	9,734	
Subtotal	556,550	144,265	700,815	
Total	\$453,719	\$1,681,001	\$2,134,720	\$931,303